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No. 82-1592

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1982

MELVYN I. WEISS, Custodian for
GARY MICHAEL WEISS, U/NY/UGMA,
Petitioner

v.

TEMPORARY INVESTMENT FUND, INC., PROVIDENT INSTITUTIONAL MANAGEMENT CORPORATION, SHEARSON LOEB RHOADES, INC., RUSSELL W. RITCHIE, ROBERT R. FORTUNE, HENRY M. WATTS, JR., DR. RALPH A. YOUNG, THOMAS S. GATES, and G. WILLING PEPPER,
Respondents

BRIEF OF PROVIDENT INSTITUTIONAL MANAGEMENT CORPORATION, RUSSELL W. RICHIE, ROBERT R. FORTUNE, JAMES LEWIS ROBERTSON, HENRY M. WATTS, JR., DR. RALPH A. YOUNG, THOMAS S. GATES AND G. WILLING PEPPER IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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Brief of Provident Institutional Management Corporation, Russell W. Richie, Robert R. Fortune, James Lewis Robertson, Henry M. Watts, Jr., Dr. Ralph A. Young, Thomas S. Gates and G. Willing Pepper in Opposition to Petition for Writ of Certiorari

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Third Circuit (per Judge Becker) is dated November 12, 1982, reported at 692 F.2d 928, and reproduced in Petitioner's Appendix at pages 1a to 29a. The dissenting opinion is reported at 692 F.2d 944 and is reproduced in Petitioner's Appendix at pages 29a to 48a. The December 30, 1982, decision of the Court of Appeals for the Third Circuit, denying petitioner's motion for rehearing *in banc*, is reproduced in Petitioner's Appendix at pages 51a to 52a.

The June 17, 1981, opinion of Judge Schwartz of the United States District Court for the District of Delaware dismissing the complaint for failure to comply with the requirements of rule 23.1 of the Federal Rules of Civil Procedure is reported at 516 F.Supp. 665, and is reproduced in Petitioner's Appendix at pages 53a - 68a. The August 27, 1981, district court opinion denying petitioner's motion for reargument and for leave to file a second amended complaint is reported at 520 F.Supp. 1098 and reproduced in Petitioner's Appendix at pages 71a - 75a.

JURISDICTION

The jurisdictional requisites are adequately set forth in the Petition at page 2.

STATUTES INVOLVED

Section 36 of the Investment Company Act of 1940 (15 U.S.C. §80a-35(b)), and Fed. R. Civ. P. 23.1 are set forth in Petitioner's Appendix at pages 79a-81a.

QUESTION PRESENTED FOR REVIEW

Did the court of appeals correctly determine that this shareholder's derivative action, brought under section 36(b) of the Investment Company Act of 1940, is subject to the demand on directors requirements of rule 23.1 of the Federal Rules of Civil Procedure?

STATEMENT OF THE CASE

In May 1980, petitioner, Melvyn Weiss, as custodian for his son, filed this derivative action on behalf of Temporary Investment Fund, Inc. (the "Fund"), a no-load open-end investment company. The petitioner sought to recover allegedly excessive fees paid by the Fund to defendants, Provident Institutional Management Corporation ("PIMC"),[1] the Fund's investment adviser, and Shearson Loeb Rhoades, Inc. ("Shearson"), the Fund's underwriter/distributor. The complaint alleged, *inter alia*, that PIMC, Shearson and the Fund's directors had breached their fiduciary duties to the Fund under section 36(b) of the Investment Company Act of 1940 ("ICA"), 15 U.S.C. §80a-35(b), by entering into the allegedly excessive fee agreements. Although the amended complaint stated that "[p]laintiff brings this action derivatively on behalf of the Fund" (Amended Complaint, ¶2(b)), the petitioner conceded that he had made no prior demand on the Fund's directors as required by Fed. R. Civ. P. 23.1.

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1. PIMC is a wholly owned subsidiary of Provident National Bank, which is a wholly owned subsidiary of PNC Financial Corp.

Respondents moved to dismiss the complaint on several grounds, including petitioner's refusal to comply with the requirements of rule 23.1. Following briefing and argument, the district court dismissed the complaint because petitioner had not complied with the rule 23.1 demand requirements. Judge Schwartz subsequently denied petitioner's motion for leave to make a post-complaint demand upon the Fund's directors and to file a second amended complaint.

On appeal from both decisions, the United States Court of Appeals for the Third Circuit affirmed the judgment of the district court. The court of appeals carefully examined the statutory scheme and legislative history of section 36(b) against the backdrop of this Court's decision in *Cort v. Ash*, 422 U.S. 66 (1975). The court determined that a shareholder suit under section 36(b) is, indeed, a derivative action and that nothing in either the statutory scheme or the legislative history of section 36(b) manifested any Congressional intent to exempt section 36(b) shareholder derivative actions from the rule 23.1 demand requirements. The court of appeals concluded:

> . . . to read the ICA's statutory scheme as depriving directors of the opportunity to respond to a shareholder grievance would undermine the very purpose of the ICA — to strengthen management of the Fund by its independent directors.

692 F.2d at 942.

The dissenting judge maintained that because section 36(b) explicitly mentions only the SEC and investment company shareholders, investment companies themselves have no right to sue under the ICA. He thus concluded that the suit was not derivative and that the rule 23.1 demand requirements were not applicable.

Petitioner's request to the Court of Appeals for the Third Circuit for a rehearing *in banc* was denied.

REASONS FOR DENYING THE WRIT

Petitioner has failed to show any compelling reason for granting a writ of certiorari in this case. The sound, scholarly decisions of the district court and the court of appeals below are wholly consistent with the purpose and legislative history of the ICA and with the prior rulings of this Court in *Cort v. Ash*, 422 U.S. 66 (1975), and *Burks v. Lasker*, 441 U.S. 471 (1979). The decisions in this case are also in full accord with the ruling of the Court of Appeals for the First Circuit in *Grossman v. Johnson*, 674 F.2d 115 (1st Cir.), *cert. denied*, 459 U.S. ___, 103 S.Ct. 85 (1982), *rehearing denied*, ___ U.S. ___ (Jan. 10, 1983).

While the decision of the Court of Appeals for the Second Circuit in *Fox v. Reich & Tang, Inc.*, 692 F.2d 250 (2d Cir. 1982), *cert. granted sub nom. Daily Income Fund, Inc. v. Fox*, ___ U.S. ___ (March 7, 1983), is out of step with the decisions of the other courts of appeals which have addressed the issue, it is respectfully submitted that that circumstance does not warrant the exercise of this Court's extraordinary and discretionary jurisdiction in this case. First, this petitioner is in no different position than the petitioner in *Grossman*, as to whom this Court recently declined to grant a writ of certiorari. Second, apparently unlike the plaintiff in *Fox*, this petitioner admitted in his amended complaint that he was bringing his suit "derivatively on behalf of the Fund," and therefore is in no position to argue belatedly that there is no such thing as a derivative suit under section 36(b) of the ICA. Third, the decisions below were correct.[2]

Each of petitioner's arguments attacking the soundness of the decisions of the district court and the court of

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2. If this Court grants the certiorari petition, these respondents respectfully request that this case be consolidated for argument with *Fox*, so that the Court may be afforded a full presentation of the issues by all interested parties. Supreme Court Rule 37.3 permits such consolidation.

appeals fails to withstand analysis. Petitioner argues, for example, that recognizing an investment company's private right of action under section 36(b) would conflict with the language and intent of that provision because section 36(b) expressly grants a right of action only to the SEC and investment company shareholders "on behalf of the investment company." That argument leads to the illogical conclusion that no one may claim the existence of an *implied* right of action unless the right to sue is *expressly* granted. However, the law as carefully set down in *Cort v. Ash*, 422 U.S. 66, 78 (1975), is to the contrary. The doctrine of implied private rights of action arose precisely because statutes obviously designed to protect certain classes of persons may not always specifically confer private remedies. As pointed out by the Third Circuit Court of Appeals, whether an investment company's right to sue its advisers is a necessary corollary of the right of action conferred on shareholders by section 36(b), as the First Circuit held in *Grossman*, or whether the investment company's implied right to sue is analyzed under the test enunciated in *Cort v. Ash*, *supra*, 422 U.S. at 78, the result is the same:

> . . . the investment company has a cause of action against the advisers for breach of the fiduciary duties imposed by section 36(b). We are aware that the Court of Appeals for the Second Circuit recently reached the opposite conclusion. *Fox v. Reich & Tang, Inc.* [citation omitted]. After careful consideration of the court's reasoning, however, we remain convinced that the investment company has a cause of action and that a §36(b) action is derivative.

692 F.2d at 936.[3]

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3. Moreover, contrary to petitioner's argument, even if an investment company were found not to have an independent right of action under section 36(b), that would not, *ipso facto*, mean that a shareholder's action under section 36(b) is not subject to rule 23.1. *See, Califano v. Yamasaki*, 442 U.S. 682, 700 (1979); *Grossman v. Johnson*, *supra*, 674 F.2d at 122-23.

Additionally, the sound policy underlying the demand requirements of rule 23.1 — the exhaustion of intra-corporate remedies prior to instituting suit — applies to a shareholder's action brought under section 36(b) regardless of whether the investment company can itself bring such a suit. *See, e.g., Hawes v. Oakland*, 104 U.S. 450, 460-61 (1882); *Mills v. Esmark, Inc.*, 91 F.R.D. 70, 72 (N.D. Ill. 1981). Faced with a timely shareholder demand, the directors of an investment company might negotiate a reduction in fees with the adviser, terminate the advisory contract, institute litigation, or convince the shareholder of the propriety of the fees.

Further, nothing in the legislative history or statutory scheme of the ICA indicates any congressional intent to exempt section 36(b) suits from the demand requirements of rule 23.1. First, Congress' stated purpose in enacting the 1970 amendments to the ICA, which included section 36(b), was to preserve and strengthen the management role of the independent directors of investment companies. *See, e.g.*, S.Rep. No. 184, 91st Cong., 1st Sess., *reprinted in* 1970 U.S. Code Cong. & Ad. News 4897, 4902-03; *Burks v. Lasker, supra*, 441 U.S. at 484-85. Allowing a shareholder to bypass the board of directors, which is responsible for managing the company, and bring a section 36(b) action entirely on his own would clearly frustrate that purpose. Second, Congress understood that the protection of rule 23.1 would apply to such actions. *See, e.g.*, remarks of then SEC Chairman Hamer Budge, *Hearings on H.R. 11995, S. 2224, H.R. 13754 and H.R. 14737 Before the Subcomm. of Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 91st Cong., 1st Sess. 201 (1969). Third, the one-year limitation on recovery under section 36(b) does not manifest any contrary intent. As noted by the Third Circuit Court of Appeals:

> . . . demand is a simple procedure that is not burdensome to the shareholders. We therefore do not believe that the one-year limitation period compels the conclusion that Congress intended to eliminate the demand requirement.

692 F.2d at 938.

Finally, contrary to petitioner's assertion (Petition at page 5), *Burks v. Lasker*, *supra*, does not undercut the propriety of the court of appeals' decision. It supports it. Nowhere in *Burks* did this Court suggest that an investment company does not have an implied right to sue under section 36(b) or that rule 23.1 does not apply to shareholder derivative actions under the ICA. Rather, this Court assumed the existence of implied private rights of action (441 U.S. at 476), and that rule 23.1 applied to shareholder derivative actions under section 36(b). 441 U.S. at 485-86 n.16. Moreover, *Burks* recognized that the structure and purpose of the ICA makes clear that Congress:

> . . . entrusted to the independent directors of investment companies . . . the primary responsibility for looking after the interests of the funds' shareholders. There may well be situations in which the independent directors could reasonably believe that the best interests of the shareholders call for a decision not to sue. . . . [citations omitted]

441 U.S. at 485.

Even if directors may not have the independent authority to terminate pending derivative suits under section 36(b), as suggested in *Burks* (441 U.S. at 484), that does not force the conclusion that Congress intended to do away with the demand on directors requirement prior to initiation of such a suit. *See, e.g.*, American Law Institute's proposed Restatement on Principles of Corporate

Governance and Structure §7.02, at 270-71 (Tent. Draft No. 1, 1982):

> It is not inconsistent for a court to employ a strict standard with respect to the excusal of demand, but then to refuse to accept a decision by the same board of directors to seek termination of the same action. . . .

Cited by the court below at 692 F.2d at 941. Thus, the court of appeals concluded:

> To allow shareholders to bypass the directors would undermine the role shaped for directors by the ICA. The opportunity to resolve the shareholder grievance without resort to litigation may, in fact, be especially important if the directors are not able to terminate the suit. In that event the Rule 23.1 demand provides the only opportunity for the fund to avert a lawsuit through internal corrective measures.

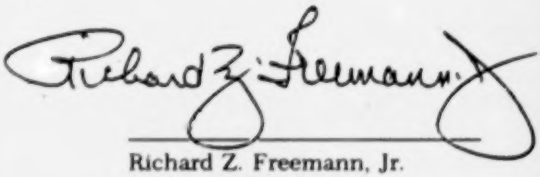
692 F.2d at 942.

In sum, like *Grossman v. Johnson*, this case does not present for review any important legal issue that was wrongly decided below. The decision of the Court of Appeals for the Third Circuit correctly analyzed section 36(b) of the ICA and Fed. R. Civ. P. 23.1. In addition, petitioner acknowledged in his amended complaint that he was suing "derivatively". He therefore was required to comply with the requirements of rule 23.1, but chose not to do so. In view of the peculiar facts of this case and the limited import of the issue raised, there is no compelling reason to grant a writ of certiorari.

CONCLUSION

The Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit should be denied.

DATED: April 25, 1983 Respectfully submitted,



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